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January 11, 2001



Mr. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Vernon:

Enclosed for filing is a signed original and 25 copies of the Rebuttal Comments of National Grain and Feed Association in the above-captioned case. Also enclosed is a floppy disk in WordPerfect format containing the text of the rebuttal comments.

Sincerely,

Andrew P. Goldstein
Attorney for
National Grain and Feed Association

Enclosures

APG/rmm

201267
ORIGINAL

BEFORE THE

SURFACE TRANSPORTATION BOARD





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EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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# REBUTTAL COMMENTS OF NATIONAL GRAIN AND FEED ASSOCIATION

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Dated: January 11, 2001

**BEFORE THE**

**SURFACE TRANSPORTATION BOARD**

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**EX PARTE NO. 582 (SUB-NO. 1)**

**MAJOR RAIL CONSOLIDATION PROCEDURES**

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# REBUTTAL COMMENTS OF NATIONAL GRAIN AND FEED ASSOCIATION

National Grain and Feed Association ("NGFA") has filed Opening Comments and Reply Comments in this proceeding. Having reviewed the Reply Comments of the Class I railroad industry, NGFA believes that certain rebuttal comments are now appropriate.

## I.

In an apparently coordinated series of replies, the major railroads and the Association of American Railroads ("AAR") choose to portray the "enhanced competition" principles of the Notice of Proposed Rulemaking ("NPR") as the flawed product of three erroneous assumptions by the Board that (1) there will not be significant public benefits from future mergers, (2) future mergers will produce unremedied competitive harms, and (3) future mergers will produce transitional service problems. See, e.g., Reply Comments of The Burlington Northern and Santa Fe Railway Company

("BNSF") at 7. The carriers argue that "enhanced competition" is an unnecessary, inappropriate and unwise predicate for future Class I rail mergers, and is not even favored by a great many non-railroad commentors. NGFA is among the parties listed by some railroads as critical of "enhanced competition."[1]

NGFA believes that the railroads misapprehend the role and purpose of "enhanced competition" in the Board's proposed regulations, and misstate the outlook of non-railroad commentors, including NGFA, toward the "enhanced competition" provisions of the NPR.

As NGFA reads the NPR, the Board is proposing that merger applicants demonstrate that their transactions will "enhance competition" because the Board believes that mergers henceforth should be evaluated more broadly than previously and should be shown to have benefits for parties other than the railroad applicants, including their customers. Contrary to the rail industry postulation of the NPR, proof of "enhanced competition" is not necessary to overcome the "three presumptions" of the railroads' litany (if, indeed, they are "presumptions" at all, which NGFA doubts). Rather, the Board has made three <u>observations</u> with which NGFA concurs: (1) route redundancy largely has been removed

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[1] NS asserts that some commentors, including specifically the U.S. Department of Transportation ("DOT"), oppose the concept of "enhanced competition." NS Reply Comments at 18-19. NS apparently has overlooked DOT's strong support for gateways that should be kept open both "physically and economically." DOT Opening Comments at 5; Reply Comments at 4.

from the rail network through prior mergers,[2] (2) future mergers are likely to have some anticompetitive impacts,[3] and (3) prior mergers have in fact produced lengthy and costly service disruptions.[4]

While the railroad industry may not like to see those conclusions reached by the Board, the railroads in fact offered no contrary facts and failed to seriously contest the Board's findings. On the record as made in this proceeding, therefore, it is accurate to say that one of the prime underpinnings for prior mergers -- a reduction of excess capacity -- is unlikely to support a public interest finding in future mergers to the same extent as previously, and it is similarly rational to infer that two of the negative results of prior mergers identified by the Board -- anticompetitive impacts and service disruptions -- may well recur

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[2] "Through mergers and other activities, railroads have now reduced most or all of their excess capacity, and have greatly improved the efficiency of their operations." NPR, Overview.

[3] "... the Board believes additional consolidation in the industry is also likely to result in a number of anticompetitive effects, such as loss of geographic competition, that are increasingly difficult to remedy directly or proportionately." NPR, proposed § 1180.1(c). Reductions in geographic competition indisputably occur where two railroads merge, even end-to-end, since at least some shippers who might have sought competing rail service through a build-out, a build-in, or truck-rail transloading, no longer would have the same opportunity to do so. Beyond that, the record is replete with shipper explanations of how prior mergers have produced market foreclosures. See, e.g., opening comments of NGFA, The Fertilizer Institute, The National Industrial Transportation League, Ag Processing Inc, and Bunge Corporation.

[4] "The last round of consolidations resulted in significant transitional service problems." NPR, Overview. That conclusion is more than amply supported in the comments of numerous shippers and shipper associations, including NGFA.

if there are additional mergers.

The duty of the Board under Section 11324 is to balance a number of factors in order to determine whether a merger is in the public interest. The Board, learning from mergers of the recent past, has determined that the requisite balancing now requires a new element; the merger, in addition to helping the applicants, must also help the public. To say that such an outlook is long overdue would be an enormous understatement. But, overdue or not, it is clearly within the Board's proper discretion.

That is not to say that NGFA believes that the Board's construction of "enhanced competition" cannot or should not be improved upon. NGFA, as explained in its Opening Comments, strongly urges the Board to clarify the parameters of "enhanced competition," and indicate, for example, that a consolidation proposal will not be deemed to satisfy that criterion solely by resulting in a larger railroad better positioned to compete with trucks. Enhanced competition should mean the ability to provide better service to the railroad's customers without detracting unreasonably from the rate and service options presently available to them.

The railroad industry is mistaken in suggesting that, because NGFA and others seek clarification of "enhanced competition," we oppose the introduction of that concept. To the contrary, it is a sound concept, squarely within the prerogatives of the Board, and

should be retained in the final rules.[5]

**II.**

NGFA strongly supports the NPR provision (proposed § 1180.1-(c)) which would require the applicant carriers "to reassure the shipping public that at a minimum major existing gateways would be kept open." Open gateways are essential if future mergers are to avoid a repetition of another post-merger occurrence -- market foreclosures brought about when carriers refuse to provide competitive rates from or to off-line destinations, as explained in NGFA's Opening Comments and the opening comments of numerous other parties.

NGFA is not merely a proponent of post-merger open gateway access to markets that were reached pre-merger, but is an advocate of such gateway access both operationally and economically. The NPR is disappointing and deficient in that it fails to make clear that post-merger gateway access must be economic as well as operational. It has never made any sense to NGFA to think that market access might be retained by nothing more than an open switch

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[5] Norfolk Southern maintains (Reply Comments at 13) that any specific rules defining "enhanced competition" not included in the NPR "cannot be included in the final rules absent additional notice and opportunity for comments." NGFA believes NS is incorrect. The Administrative Procedure Act, 5 U.S.C. § 553(b)(3), provides that an agency can provide notice of "either the terms or substance of the proposed rule or a description of the subjects and issues involved." The courts have held that "[n]otice need not contain every precise proposal which the agency may adopt as a rule. Rather, notice is sufficient if the description of the 'subjects and issues involved' affords interested parties a reasonable opportunity to participate in the rulemaking." Trans-Pacific Freight Conference of Japan/Korea v. Federal Maritime Commission, 650 F.2d 1235, 1248 (D.C. Cir. 1980).

at a major gateway, leaving it to the merged carriers to block use of the gateway, as they have in the past, through rate action or inaction clearly designed to deter the movement of traffic over the gateway, and serving no other public purpose.

Among the major railroad commentors, only BNSF appears to expressly favor gateway access on both operational and economic grounds. BNSF Reply Comments at 10. Unfortunately, however, BNSF opposes any rule which would define an open gateway or measure access, maintaining that one or more different gateway conditions should evolve in each merger proceeding.

CSX is not overtly opposed to gateway conditions, but believes they somehow should be tied to specific origins, destinations, and commodities (CSX Reply at 38). Norfolk Southern is generally agreeable to some sort of a gateway condition, provided it does not apply to each and every gateway and is analyzed on a case-by-case basis. NS Reply at 24. Union Pacific, while professing support for open gateways, proposes a methodology which undermines completely the concept of gateway access in the form of a bottle-neck rate structure which would compel shippers to bring rate cases in order to gain gateway access.

NGFA urges the Board to provide further definition for the open gateway provisions in the NPR. What is at issue is whether the Board agrees that "open gateway" conditions will have little or no meaning unless they are interpreted as requiring "economic" access. If the Board does agree with that concept -- as NGFA thinks it must if open gateways are truly to retain or enhance

competition -- then it should say so in the final rules. If prospective parties to a merger proceeding are left to guess at the meaning of "open gateways," they will lack those benchmarks that customarily are of assistance in negotiating resolutions to their merger concerns or in preparing evidence in contested proceedings. Either is a needlessly inefficient predicament. On the other hand, should the Board intend to permit "open" gateways to be closed through those rate actions intended solely to deter the use of the gateway, the Board should clearly say so at this point in order that parties not needlessly waste their resources in the quest of merger conditions that the Board has no intention of imposing.

**III.**

NGFA and others were critical of the NPR for failing to propose more concrete remedies in the event that service failures and commercial injury follow the next round of mergers, as they have, to one degree or another, in virtually all of the recent mergers. The NPR's approach is to have the applicant carriers propose their own "damage control" plan and for the Board to participate in a post-merger monitoring process. Shippers and shipper organizations, including NGFA, urged the Board to go further. NGFA in fact proposed specific provisions which would --

A. Institute a rule requiring railroads to respond to service failure damage claims within 120 days of receipt of the claim, similar to the procedures now in effect at 49 C.F.R. § 1005 for the processing of loss and damage claims; and

B. Require applicants to apply a market compensation standard in evaluating damage claims for service failures and terminate arbitrary rejections of claims;

C. Use the Board's merger-conditioning authority to require the applicants to subject themselves to arbitration for the resolution of service failure claims that are not settled voluntarily.[6]

So far as NGFA is aware, neither AAR nor any major railroad specifically opposes the first of the NGFA proposals which, even were it opposed, is so plainly consistent with the Board's existing rules, and so clearly workable, that it should be incorporated into the final rules in this proceeding.

On the other hand, the suggestions of NGFA (and others) for adoption of a "market compensation" or similar liability standard, and for arbitration of claims disputes, met with general disfavor among the railroads. The AAR, representing the views of all Class I railroads except Canadian National, argues that, when post-merger service disruptions force shippers to purchase truck service as a substitute for failed rail service, the shippers are merely demonstrating their access to competitive alternatives and therefore require no assistance through any form of damage or liability rule on the part of the Board. AAR Reply Comments at 14. Individually, CSX condemns proposals like those of NGFA simply because they would involve a "Board-compelled process" as a

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[6] NGFA Opening Comments at 12-13.

substitute for existing claims procedures. It suggests that its customers purchase insurance coverage for losses sustained as a result of post-merger service problems. CSX Reply Comments at 41.

In an argument sorely lacking in logic, the railroads generally maintain that, because they, themselves, suffer financially from their own post-merger service failures, the Board should spurn shipper requests for a more responsive liability regime. See, e.g., Norfolk Southern Reply Comments at 38-39. If there is a rationale behind this argument, it seems to be that, where railroads' stockholders suffer, railroad customers should be accorded no regulatory remedies.

While railroad resistance to improved claims procedures is not unexpected, it should not satisfy the Board. Nor should the Board defer all further consideration of post-merger service failure remedies to a case-by-case evaluation.

The NPR urges the parties to pursue private sector remedies. Any such remedies normally would include agreements as to service standards and liability; indeed, some carriers expressly propose that they negotiate service performance standards and liability provisions with their customers, and NGFA endorses that approach. NGFA is not requesting the Board to include in its final rules any determination of carrier liability for particular forms of damages. We do urge that the Board establish a framework that will help guide the parties through any private sector negotiations they wish to undertake or, alternatively, serve as a benchmark for remedial requests if private negotiations fail and these issues are pursued

in a merger adjudication. That framework should include a statement that carriers will be expected to be fully responsible for service failures and should encourage the use of arbitration to resolve disputes.

Recent mergers have, in fact, been extremely costly to shippers, whose efforts to obtain compensation frequently have been rebuffed by the railroads.[7] The Board should not expect railroad customers to bear the costs of merger-related service failures that are not of the customers' making. Contrary to the "Chicken Little" arguments of the railroads, the Board is not being asked to remake itself into a damage tribunal. It is, instead, being asked to use its authority to establish a workable, responsive system of redress.

**IV.**

NGFA would like to conclude these rebuttal comments by noting its agreement with certain carrier suggestions.

After analyzing the filings of the rail industry, NGFA believes that Union Pacific has offered what may be a sensible compromise regarding the difficult issue of a "downstream" analysis of a merger's implications. In essence, UP's suggestion is that the "next major Class I merger proceeding ... focus on whether a North American railroad duopoly is in the public interest," without

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[7] See Union Pacific Reply Comments at 11, where UP continues to advocate that liability for post-merger service failures be limited to the cost of substitute trucking or other transportation costs, a clear indication of the highly restrictive view which railroads take of their responsibility for post-merger service failures.

requiring the applicants to specifically identify the participants or components of such a duopoly. Union Pacific Reply Comments at 8. Of course, it is entirely conceivable that little or no guesswork may be involved in identifying the resulting combinations that will follow the first merger initiative.

NGFA thinks that the UP proposal will suffice to put in play the question of whether a rail duopoly is in the public interest. That is not to say, however, that the Board's review of "downstream" effects should stop there. The Board is empowered to retain conditioning authority for use in the event that subsequent changes in the structure or expectations of the rail industry are altered. The Board, in fact, utilized exactly such authority in the Union Pacific-Southern Pacific merger and, to some extent, in the Norfolk Southern and CSX acquisitions of Conrail. The final rules in this proceeding should make clear that the Board will reserve authority to impose further conditions in the event that "downstream" transactions sufficiently alter the competitive situation so as to warrant such steps.[8]

NGFA also finds itself in agreement with an additional position advanced by Union Pacific: future mergers should not be

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[8] Some carriers, notably BNSF, argue against any expressed reservation of jurisdiction on the ground that the financial markets abhor uncertainty. However, NGFA respectfully suggests that the stakes at this point -- the possibility of America's railroads being reduced to a duopoly or, more realistically, to a dual monopoly -- counterbalance the alleged concerns of the financial community. Wall Street sometimes abhors depletions of the assets of non-railroad companies brought about through undue exercises of railroad market power.

approved unless the Board is convinced that the merger will deliver net benefits to all concerned, and not just the merging carriers. This balancing process should include retention of the proposed requirement that the applicants demonstrate that the benefits they hope to achieve cannot otherwise be attained. See Union Pacific Reply Comments at 20-21.

There is unlikely to be any turning back from the next round of Class I rail mergers to come before the Board. NGFA believes that the NPR is on the right track in departing from the narrow precedent of prior mergers, developed in a rail industry that did not even vaguely resemble the market concentration now present or to be created through additional mergers. NGFA urges the Board to reject the many railroad arguments for retention of the status quo in the Board's outlook toward future rail mergers.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing pleading has been served on all parties of record by first class mail, postage prepaid, this 11th day of January, 2001.

Andrew P. Goldstein

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